BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 35506

WESTERN COAL TRAFFIC LEAGUE – PETITION FOR DECLARATORY ORDER

REBUTTAL ARGUMENT OF CONSUMERS UNITED FOR RAIL EQUITY

231561

Robert G. Szabo
Executive Director and Counsel, CURE
Michael F. McBride
Van Ness Feldman, PC
1050 Thomas Jefferson Street, NW
Suite 700
Washington, DC 20007-3877
(202) 298-1800 (Telephone)
(202) 338-2416 (Facsimile)
rgs@vnf.com
mfm@vnf.com

Attorneys for Consumers United for Rail Equity

December 20, 2011

BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 35506

WESTERN COAL TRAFFIC LEAGUE – PETITION FOR DECLARATORY ORDER

REBUTTAL ARGUMENT OF
CONSUMERS UNITED FOR RAIL EQUITY

Consumers United for Rail Equity ("CURE") hereby submits its Rebuttal Argument to the Reply Evidence and Arguments submitted by the Association of American Railroads ("AAR") and BNSF Railway Company ("BNSF") in response to the Opening Evidence and Arguments submitted by CURE and various other parties in support of the Petition for Declaratory Order filed herein by Western Coal Traffic League ("WCTL").

I

THIS MATTER IS A CASE OF FIRST IMPRESSION AND IS NOT GOVERNED BY RULINGS IN THE CASES CITED BY THE RAILROADS.

In the previous rulings of the Board and its predecessor on this issue, the factual circumstances were that one railroad was acquiring or merging with a second railroad. In these cases, the Board allowed the acquisition premium to be added to URCS costs and the combined railroad investment base on the theory that there were efficiencies gained in the merger or acquisition that benefitted consumers. In only one previous instance since

1980 did an investment fund purchase a railroad. In that case[1] the Interstate Commerce Commission was not asked to make a ruling on the issue of the acquisition premium. Thus, CURE maintains that this is a case of first impression, not governed by previous decisions of the Board or its predecessor.

II

THE BOARD HAS THE AUTHORITY AND DUTY TO DETERMINE IF THE BERKSHIRE HATHAWAY-PAID PREMIUM SHOULD BE INCLUDED IN BNSF'S URCS COSTS OR IN ITS INVESTMENT BASE.

In its Reply Comments, AAR argues that the Board is required by GAAP accounting rules to include the acquisition premium paid by Berkshire Hathaway in the URCS costs and investment base of BNSF. This argument is not correct. The Rail Transportation Policy[2] governs the Board's regulation of the railroads and requires the Board to regulate in a manner that is "fair," "accurate," and "reasonable." It would be unfair, inaccurate, and unreasonable to allow BNSF to include in its URCS costs or its investment base an expense that it did not incur for reasons that we will set forth below.

Separately, the Board was directed to "periodically review its cost accounting rules and shall make such changes in those rules as are required to achieve the regulatory purposes of this part."[3] Pursuant to that Congressional directive, the Board is permitted or even required to depart from GAAP accounting rules when it is not practical or appropriate to follow those rules.[4] Congress required that the Board act in the public

---

[1] Blackstone Capital Partners, L.P. – Control Exemption – CNW Corporation and Chicago and North Western Transp. Co., 5 I.C.C.2d 1015 (1989); *see* BNSF Opening Evidence and Argument at 21.
[2] 49 U.S.C. § 10101.
[3] 49 U.S.C. § 11161.
[4] When the Interstate Commerce Commission revised its revenue-adequacy standards and decided to use written-down values of railroad assets when they were purchased for less than book value, the ICC's determination was found to be within its statutory authority

interest, not in accordance with the opinions of the accounting profession, in implementing its regulatory responsibilities in a fair, accurate and reasonable manner.

BNSF argues that the Board should not grant the relief sought by WCTL because "the shippers point to no changes in the law that would suggest a departure from long-standing precedent..." and "[t]here has been no change in circumstances that could possibly justify reversing that settled policy and practice in this proceeding."[5] We, of course, maintain that the facts of this matter are different from and not controlled by earlier decisions of the Board relied upon by the AAR and BNSF. We also maintain that, consistent with 49 U.S.C. § 11161, the Board may always change its interpretation or application of the law, as long as the action taken is within the legal authority of the Board and the Board states a reasonable basis for its decision. The Board, as is true of any other regulatory agency, may change its policies so long as the law permits the change and so long as it provides a "reasoned analysis" for the changed policy, whether or not the circumstances are different now than at the time the policy was adopted.[6] Agencies are not prisoners of their prior policy determinations, but may adapt their policies as they deem appropriate.

---

and its determination was given deference. Association of American Railroads v. ICC, 978 F.2d 737, 740-43 (D.C. Cir. 1992). When Congress subsequently enacted the Interstate Commerce Commission Termination Act of 1995, including the current 49 U.S.C. § 11161, it explicitly directed the Board to make further changes to its "cost accounting rules ... as are required to achieve the regulatory purposes of this part," as discussed in text. Accuracy in cost-accounting rules, and fairness in their application, must be at the top of such Congressional purposes as set out in the Rail Transportation Policy.

[5] BNSF Reply Evidence and Argument at 4-5, 27-29.

[6] Motor Vehicle Mfrs. Ass'n of United States, Inc. v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 42 (1983)("an agency changing its course by rescinding a rule" or departing from precedent "is obligated to supply a reasoned analysis for the change"); *see* Greater Boston Television Corp. v. FCC, 444 F.2d 841, 852 (D.C. Cir. 1970).

III

THE BOARD SHOULD NOT ALLOW THE ACQUISITION PREMIUM TO BE INCLUDED IN THE BNSF INVESTMENT BASE OR TO AFFECT BNSF'S URCS COSTS BECAUSE BERKSHIRE HATHAWAY, NOT BNSF, PAID THE PREMIUM.

Most basically, the reason that the Berkshire Hathaway-paid acquisition premium should not be included in BNSF's URCS costs and should not affect BNSF's investment base for use in the Board's revenue adequacy calculations for BNSF is simply this: BNSF did not pay the premium. In other words, BNSF should not be permitted to include in its URCS costs an amount that it did not pay.[7] There is no logical reason why the Board should treat BNSF in the real world as having incurred a cost it did not incur, or as being less revenue-adequate (or, according to the Board, more "revenue-inadequate") based on a premium paid by a different entity (here, Berkshire Hathaway) to acquire BNSF. That premium does not represent either costs incurred or investments made by BNSF.

If the Board prevents BNSF's URCS costs and investment base from reflecting any portion of the Berkshire Hathaway-paid acquisition premium, BNSF would not be adversely affected, because it would be in precisely the same place it was in before the acquisition. BNSF is the same railroad, with the same costs, and the same management, as it was before it was acquired by Berkshire Hathaway. There is, therefore, no reason to treat BNSF, for regulatory purposes, any differently than before Berkshire Hathaway paid an enormous premium to acquire BNSF.

---

[7] BNSF witnesses Kolbe and Neels maintain that original-cost ratemaking results in revenue-inadequate regulated entities. CURE believes that all other economic regulatory agencies in the United States use original-cost ratemaking. CURE also believes that there are many regulated entities in the United States that are indeed revenue-adequate, defined as being able to attract and retain capital.

IV

THE BOARD SHOULD NOT ALLOW THE INCLUSION OF THE ACQUISITION PREMIUM IN THE INVESTMENT BASE OF BNSF OR THE PREMIUM TO AFFECT THE URCS COSTS OF BNSF.

SUCH TREATMENT WILL NOT INCREASE THE ABILITY OF BNSF TO ATTRACT AND RETAIN THE CAPITAL REQUIRED FOR ITS SYSTEM.

Unlike in previous cases where the Board ruled on the acquisition premium issue, the transaction herein did not result in a "stand-alone" railroad company that is required to compete in the open market for capital. BNSF is no longer a publicly traded company, so no investment advisors will be examining the profitability of BNSF to determine whether or not to advise the purchase or sale of BNSF stock. Thus, allowing the acquisition premium herein will not allow BNSF to be more attractive in capital markets. BNSF is now a unit of one of the nation's largest capital funds, Berkshire Hathaway, and will no longer be required to access capital debt markets as a "stand-alone" railroad. Thus, allowing the acquisition premium treatment sought by BNSF will not improve its ability to gain access to debt capital in financial markets.

Rather, BNSF is now a unit of a very large and very successful capital fund that will be able to provide for all of the capital needs of BNSF. Certainly, Berkshire Hathaway believes BNSF is a valuable investment based on both the acquisition premium it paid for all the stock of BNSF and based on the 2011 Chairman's letter to investors in Berkshire Hathaway touting the profitability of the BNSF – without the acquisition premium treatment objected to herein by the WCTL.

Thus, the acquisition treatment proposed by the BNSF will not improve the railroad's access to capital.

V

THE ACQUISITION PREMIUM TREATMENT BY THE BNSF IS NOT APPROPRIATE WHERE THE REGULATOR USES THE NOMINAL COST OF CAPITAL.

BNSF's economic witnesses Kolbe and Neels contend (V.S. at 6-10) that it makes economic sense to include the acquisition premium in BNSF's URCS costs and investment base because they contend that some form of regulation other than one based on original cost is preferable. However, the purpose of this proceeding is not to determine whether the Board's ratemaking methodologies – "stand-alone cost" or "simplified stand-alone cost" or "Three-Benchmark" comparisons – each of which may result in rates prescribed on the basis of a railroad's actual URCS costs -- should continue to be applied. Rather, the purpose of the exercise is to determine whether BNSF's URCS costs should be adjusted to include the effect of the Berkshire Hathaway-paid premium, for use in applying those ratemaking methodologies and determining the annual revenue adequacy of BNSF

In any event, BNSF witnesses Kolbe and Neels candidly acknowledged what the RAPB Report, at pages 41-42 of Chapter 7, acknowledged: that asset values should be based on historic costs when the agency uses the nominal cost of capital to determine revenue adequacy (as the Board of course does), so as to avoid a "double count" of inflation.[8]

---

[8] V.S. at 20. Witnesses Kolbe and Neels contend that this concession should only apply "[i]f, contrary to fact, railroads had been able to consistently earn a real cost of capital return on the replacement cost of their assets." *Id.* They cite no authority for that assertion. In order to have a claim for relief from the application of an otherwise legitimate regulatory policy that a party claims prevented it from fully recovering its costs (including a fair return), it must be shown that the actions of the regulator, rather than the marketplace, caused the regulated entity not to recover its costs fully. Market Street Railway Co. v. Railroad Comm'n, 324 U.S. 548, 568 (1945). Because BNSF

VI

BNSF'S TREATMENT OF THE ACQUISITION PREMIUM COMPLAINED OF HEREIN HAS ONLY ONE EFFECT: TO DENY SOME CAPTIVE RAIL CUSTOMERS OF BNSF ACCESS TO THE STB TO CHALLENGE THEIR RATES.

GOOD PUBLIC POLICY REQUIRES THE STB TO REJECT BNSF'S TREATMENT OF THE ACQUISITION PREMIUM IN ORDER TO MAINTAIN ACCESS TO THE STB BY ALL CAPTIVE RAIL CUSTOMERS OF THE BNSF.

What is the purpose of BNSF's efforts to include the Berkshire Hathaway-paid premium in BNSF's URCS costs and investment base for regulatory purposes? Certainly, it is not to permit BNSF to raise rates on unregulated traffic.[9] There is no dispute that rates on unregulated rail traffic are set by the marketplace, not by regulation, so any effect of the Berkshire Hathaway-paid premium on regulatory policies is irrelevant to unregulated traffic.

BNSF's treatment of the acquisition premium complained of herein will not increase BNSF's access to capital, as discussed previously. Thus, the only apparent purpose of its acquisition premium treatment is to deny some captive rail customers on its system the right to challenge their rates at the Board. BNSF's acquisition premium treatment will (1) increase the effective threshold (stated as a percentage of BNSF's variable costs) for Board jurisdiction over BNSF's rates, so as to effectively deregulate some traffic now subject to the Board's jurisdiction,[10] and (2) to force the Board to

---

concedes that most of its rates are unregulated, and instead are established in the marketplace, it could not make such a showing, nor has it attempted to do so.

[9] *E.g.*, BNSF Reply Evidence and Argument at 15 ("[m]arket forces restrain most rail rates…."); Verified Statement of John P. Lanigan at 4 (even for traffic "potentially subject to rate regulation by the Board," BNSF "establishes rates for this traffic in the same way that it sets rates on its other traffic – in accordance with market conditions."); Joint Verified Statement of A. Lawrence Kolbe and Kevin Neels at 13 ("most rail markets are workably competitive.").

[10] While BNSF Witness and Executive Vice President and Chief Marketing Officer Lanigan claims (V.S. at 5) that any increase in BNSF's URCS costs due to use of GAAP

increase the level of reasonable rates challenged under the Three-Benchmark simplified procedure because of the impact of the premium on BNSF's URCS costs and investment base (the latter of which would allow BNSF to increase the rate that would otherwise have been prescribed under the Board's "Three-Benchmark" rate guidelines).

If these were not the purposes of BNSF's acquisition premium, then BNSF would not have included the acquisition premium in its R-1 filing in March, 2011. But, BNSF did include the acquisition premium in its R-1 filing and is fighting hard to maintain this artificial inflation of its costs and investment base. If the Board allows BNSF to inflate its costs and investment base artificially through this unilateral accounting action, some captive rail customers of BNSF – beyond those whose rates have been adjudicated by this Board and whose reasonable rates have been expressed in terms of a revenue to variable cost relationship – will lose their right either to threaten in negotiations to challenge BNSF's proffered rates at the Board or to actually challenge those rates at the Board.

In an earlier filing, based on the filings of BNSF in this matter, we estimated that BNSF's action herein has the effect of increasing by over 10% at least some of the BNSF rates that are currently at the 180% jurisdictional threshold. If the Board allows the BNSF action herein to stand, at least some captive rail customers on BNSF will have experienced a ten percent rate increase without BNSF running the risk of having any of those rates overturned by the Board.

---

purchase accounting "would have no impact on the rates that these shippers [*i.e.*. those whose rates "happen to have R/VC ratios that are very close to the Board's jurisdictional threshold"] pay," the fact is that increasing BNSF's URCS costs would effectively increase the Board's jurisdictional threshold and prevent those shippers from even being allowed to seek a rate prescription from the Board.

Because this result will not improve BNSF's access to capital, this unilateral action by BNSF - which denies at least some of its captive rail customers the protection legislated by Congress in the Staggers Rail Act of 1980 and the ICC Termination Act of 1995 - simply cannot constitute good public policy or be in the public interest.

CONCLUSION

For the foregoing reasons, and those stated by WCTL in its Petition filed herein, and by the USDA, CURE, and the other shipper entities and associations in their previous filings herein, as well as the portions of BNSF's Reply Evidence and Argument cited herein, the Board should (1) grant the relief sought by WCTL, and (2) deny the relief sought by BNSF. Specifically, the Board should ensure that the assets of BNSF are not written up to account for the premium paid for BNSF by Berkshire Hathaway, for both URCS costing purposes and for purposes of determining BNSF's investment base used in determining BNSF's revenue adequacy.

Respectfully submitted,

Michael F. McBride

Robert G. Szabo
Executive Director and Counsel, CURE
Michael F. McBride
Van Ness Feldman, PC
1050 Thomas Jefferson Street, NW
Suite 700
Washington, DC 20007-3877
(202) 298-1800 (Telephone)
(202) 338-2416 (Facsimile)
rgs@vnf.com
mfm@vnf.com

Attorneys for Consumers United for Rail Equity

December 20, 2011

Certificate of Service

I hereby certify that I have served, this 20th day of December, 2011, a copy of the foregoing Rebuttal Argument of Consumers United for Rail Equity on each person shown on the Board's official service list in this proceeding.

Michael F. McBride

Michael F. McBride